

I. INCOMPLETE RETURNS PROGRAM

1. Introduction

This topic will explore the various aspects of the new incomplete returns program and provide you with an understanding of just how the program will operate. Through this discussion we hope to make all personnel aware of the reasons for our concern about incomplete returns, the legal considerations in development of the program, and the correspondence role of the Service Centers. Particular attention will be given to what constitutes an incomplete return and the examining specialists' responsibilities. Since the development of some specifics of the program are still under consideration and not yet finalized, some discussions will provide only our current thinking, which could be modified or altered in the final plan. Additionally, we will be utilizing some temporary procedures until certain required computer system modifications can be made.

2. Background

As a result of the Tax Reform Act of 1969, the class of organizations required to file information returns was broadened to include all organizations except churches and certain organizations with gross receipts of \$5,000 or less. In broadening the class of organizations required to file, we are aware that some inconvenience and expense is involved on the part of organizations in meeting the filing requirements imposed by IRC 6033(a). This burden is shared by hospitals, schools, homes for the aged, organizations providing aid to the needy, fraternities and sororities, and many other worthy organizations.

The new requirement results partly from Congressional recognition of the need for taxing authorities to keep in touch with exempt organizations and have some objective basis for deciding which organizations should be examined for verification of exempt status. Equally important is the concern of Congress that the financial status of exempt organizations should become a matter of public record since the inspection of such returns by the public is expressly provided for in IRC 6104(b).

Over the years, we have observed that a significant portion of our Form 990 series returns were not being satisfactorily completed by the taxpayer, thereby seriously hindering our ability to make accurate and reliable tabulations of data from the returns. In addition, various Congressional subcommittees have expressed

concern about missing information from returns that they need for their investigations. We have also had many complaints from taxpayers discovering through public inspection of the returns that certain information is not being provided as required by law. The need for a complete return has become even more important since acceptance of our Form 990 by states with reporting requirements. It is a problem which we have been working on for some time.

Most recently, in response to GAO's report entitled "Public Information Reporting by Tax-Exempt Private Foundations Needs More Attention by IRS," our Assistant Commissioner (OP:E) testified before the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, that the Service would implement such a program. Such action is appropriate since the Commissioner's Office had earlier approved GAO's recommendation that the Service establish procedures for assessing a penalty in those instances when the IRS, through its overall approach, is unable to secure an organization's voluntary compliance with information reporting requirements, and for revoking an organization's tax-exempt status when ultimately we are unable to obtain the information necessary to establish the organizations continuing qualification for exemption.

3. Past Actions

A major part of the problem of incomplete returns, to be sure, is the fact that many taxpayers do not fully understand what is required for specific line items on the return. In an attempt to clarify the more important items with respect to Forms 990-PF and 990, filed by organizations exempt under sections 501(c)(3), (4), (6) and (7), we prepared supplemental instructions that contain an example of a filled-in return with explanations. In addition to the hypothetical figures, the returns designate those special lines that are crucial for our data gathering purposes.

In late 1975, Chief Counsel rendered an opinion that the penalty for failure to file timely under IRC 6652(d) also applies to organizations that omit certain information from the Form 990 series returns. This principle was published as Rev. Rul. 77-162, 1977-1 C.B. 400, on May 9, 1977. In addition, the instructions to the 990 series returns were changed to reflect this revenue ruling and encourage taxpayers to be certain the return was properly completed. The returns in question are not sent back to the organizations, but retained and the parties concerned notified that unless the Service is promptly supplied the missing information, applicable penalty provisions will be invoked. Under IRC 6652(d)(1) the filing of

an incomplete return is considered the same as failing to file a return, and therefore the period of limitations under IRC 6501(c)(3) does not commence.

In order to expand the range of information contained in the Exempt Organizations Business Master File (EO/BMF), we increased the number of items from the 990 series returns that will be keypunched during processing at the Service Centers. We identified those items from each of the 990 series returns that must contain an entry for that return to be considered complete. All of those are items to be keypunched. If no entry is made in any one of these items (and only these items) and the information cannot be obtained from some other portion of the return, under procedures now in effect, the Service Centers correspond with the filer to obtain the needed information. We have revised the initial correspondence letter to advise the taxpayer of the possible penalty of \$10 per day if the information is not furnished, or reasonable cause for failure to furnish it is not given. Currently we take no follow-up action.

Another major action taken was the exercise of the Commissioner's discretionary authority in relieving certain organizations from filing if their receipts are under \$10,000. This eliminated the filing requirement burden from many small organizations. In addition, a major recommendation of the Exempt Organization Delinquency Study to raise the gross receipts level for requiring the filing of a return from \$10,000 to \$25,000, was adopted for tax years beginning after December 31, 1981.

Furthermore, we removed from the Form 990 return the line item requesting the filing organization to report the fair market value of its assets. This action was taken as many complaints had been received from filing organizations and return preparers that the item was costly and burdensome to report and there was serious doubt about the reliability of the information collected. In addition, we found many organizations did not complete this line item when initially filing which required the Service to correspond with the organizations. In a survey we conducted, this one item was discovered to be the most frequent cause for correspondence.

Most recently, we have revised Form 990-PF which is now a consolidation of the former Forms 990-PF and 990-AR.

4. New Program

a. General

The publicity of exempt organization information is clearly recognized by the Service as a major part of its responsibility in administering the exempt organization provisions of the Code, and this recognition has contributed significantly to the development of the present forms. Additional reasons for the development of the form to its present state include the Service's need for audit leads and the need to gather statistical, financial, and other data about the affairs of organizations that are useful to the public and to the Congress. The Service can only fulfill these responsibilities if it has an appropriately designed report form that gathers the desired information in an understandable manner. For these reasons, the Service has a responsibility to ensure the completion of the exempt organizations returns that are received in our Service Centers.

Our new program, as designed, involves a systematic approach which combines an appropriate mix of increased correspondence and examination related functions. The major emphasis of our program is directed to ensuring the perfection of incomplete returns at the Service Centers when first received. This approach assures that requests for public inspection would be provided with a complete return and that information needed in the selection of returns for examination and for tabulation or statistical purposes will be available on the returns. The primary purpose of the entire program is not to penalize an organization for not furnishing needed information but rather to secure the information and complete returns. Based upon our current plan of action we anticipate implementation of the program and the assertion of penalties on 1983 calendar year returns filed in 1984.

Since our program is new, modifications will undoubtedly be made as we gain experience and data on the effectiveness of our program. In developing our program, substantial consideration was given to the legal basis for imposing a penalty if a line was incomplete. While we believe each and every line item on the returns is needed by the Service to effectively administer the laws, it may be difficult to justify a "failure to file" penalty for certain line items being incomplete. Accordingly, we have chosen to focus initially on only the line items required by the Code, Regulations or a Revenue Procedure. While the Service Centers will correspond on other missing line items, the penalty will be assessed only on certain specific incomplete return line items if not provided (see 4b following). Possibly, in the long run, however, an effective taxpayer education program will do more than anything else to ensure the receipt of high quality returns.

b. Definition of an Incomplete Return

In essence, the specific line items, if missing, that could subject an organization to the \$10 per day penalty under IRC 6652(d) are those line items required to be reported by exempt organization under section 6033 of the Code or Regulations or a Revenue Procedure. Attached is Exhibit A which lists the correspondence line items from the 1983 Form 990 and Form 990-PF. These are the specific line items we are dealing with in our incomplete returns program that if not completed will subject the organization to the \$10 per day penalty. As we indicated previously, there are other line items needed for monitoring purposes which the Service Centers will correspond on if missing, but if not provided, will not subject the organization to a penalty.

c. Service Centers Function

(1) General

The major emphasis at the Service Centers will be directed to ensuring the perfection of incomplete returns shortly after they are first received. Specifically, increased attention will be given in the future to securing missing information that is required by law and relevant to the needs of grant-seekers and other interested members of the public.

(2) Correspondence Procedures

Based upon the initial decision by a Service Center tax examiner, we will send to those organizations that do not file a complete return a letter requesting that they send us the missing information within 60 days. This letter will also inform them that the delinquency penalty applies for filing an incomplete return and revocation of exempt status is also possible if the organization does not provide the information or show reasonable cause for the failure to provide the needed information. This letter will clearly indicate we will not assess a penalty if the missing information is provided.

We will automatically send a second letter to the organizations that do not respond to our first letter, requesting that they send us the needed information within 30 days. This letter will advise that unless the information is received within the specified period, a \$10 per day penalty will be assessed from the due date of the return to the end of the allotted response period. This letter will also allow the organization to show reasonable cause for the failure to provide the needed information. At that time the case will be placed in suspense pending a response or expiration of the allotted response period.

If the organization responds providing the information or acceptable reasonable cause, the penalty will not be assessed. If the organization does not respond, the penalty will be assessed.

If the organization responds and provides cause which is determined by a Service Center tax examiner to be unacceptable, the penalty will be assessed and the organization will be notified and afforded a hearing with an Appeals Officer. The case will then again be placed in suspense pending expiration of the allotted appeal period. If the organization responds and the request for penalty adjustment is acceptable to the Appeals Officer, the penalty will be abated. If the organization does not respond or the request for a penalty adjustment is disallowed by the Appeals Officer, the organization will be so advised.

If acceptable reasonable cause or the missing information has not been provided by the organization after correspondence by the Service Center, the \$10 per day penalty will be assessed and a bill sent. The penalty will be computed from the due date of the return to the final date of the allotted response period of the second letter. We are not precluded from assessing the IRC 6652(d) penalty prior to reaching the maximum \$5,000 penalty and have adopted this approach for the simplicity of the effective date for the revocation of the organization's exempt status if deemed appropriate. This matter will be discussed in more detail later. If the bill sent to the organization is not paid, a tax delinquency account (TDA) will be generated for collection action.

(3) Reasonable Cause Criteria

Since in dealing with an incomplete return the Service has received a document that only lacks some information, most of the reasons acceptable as reasonable cause for filing a delinquent return are not appropriate or applicable. For example, while the unavoidable absence of the individual having sole authority to file the return is acceptable reasonable cause for filing a late return, such reason would be totally unacceptable for filing an incomplete return. The only acceptable reasonable cause for not completing a return would be that specific records to ascertain the needed or missing information are not available for reasons beyond the organization's control. Accordingly, a conservative approach should be taken in accepting a reason for not filing a complete return. Each case must be judged on its own merits and, naturally, any reason offered should clearly establish justification for not providing the missing information.

(d) Field Function

(1) General

Our original plan was for the returns of those organizations that fail to respond to the Service Center's correspondence effort, by providing all the needed information or acceptable reasonable cause, to be automatically sent to the Key District Offices (KDO) for further consideration. A computer system adjustment is necessary for the Service Centers to utilize a computer generated notice to control such causes. This cannot be completed until 1985, so that for now, such returns will be placed on the Audit Classification Register (ACR) for the KDOs to select those cases for further consideration. The specific procedures on the further action to be considered are currently being developed and will be placed in the IRM.

We believe the completeness of a return as determined by an agent goes far beyond a Service Center determination as the agent also deals with proper completeness of a return and the quality of the information being reported. A return determined complete by Service Center standards, i.e., an entry on certain lines, might well be considered improperly completed by an agent if an item is reported incorrectly. For example, a line item not corresponded on by the Service Center could be used by agents for a change if upon examination it is determined an amount should have been reported but was not, and/or if an amount was reported but found to be an incorrect amount. However, we do want to emphasize that for purposes of the penalty and revocation action on our incomplete returns program we are only talking about those line items required by the Code, Regulations, or a Revenue Procedure and corresponded on by the Service Centers.

(2) Procedures for Service Center Referrals

As currently planned, we will not require the KDOs to examine these cases. The KDOs should, however, secure such returns, taking into consideration workload restrictions, to determine what actions, if any, are still needed. Bear in mind that in the past we sent only one letter and if no response was received we did nothing. Now we will be sending two letters and assessing a penalty. For the first year that might be all that is necessary to get the organizations to file complete returns. After the required computer adjustments are made, such returns will automatically be sent to the KDOs.

After receipt of the return, EO personnel should review the information requested by the Service Centers to verify such information is not included

elsewhere on the return and the penalty assessment is proper. If the penalty assessment is determined to be improper, the Service Center should be so advised and the penalty recommended for abatement.

Assured that the needed information is in fact missing, the KDO should consider the application of the IRC 6652(d)(2) penalty against the exempt organization official or trustee who fails to file the complete return. This will require the issuance of a written demand notice from the Service to the responsible official. We believe this sanction will help achieve a greater rate of compliance with the program. Should the organization provide the missing information to the KDO after completion of the Service Center's unsuccessful correspondence effort, the assessed penalty should not be abated. At this stage, the only justified reason for abating the penalty would be if the organization is able to provide acceptable reasonable cause for the failure to provide such information timely. Revocation of an organization's exempt status is appropriate in the exceptional case where the sanctions of IRC 6652(d)(1) and (2) have proved to be ineffective in securing compliance with IRC 6033, and the organization's continued entitlement to exempt status is substantially in doubt. The effective date of revocation, when the sanction is applicable, would be subsequent to the imposition of the IRC 6652(d) penalties. If the issuance of the notice of demand does not produce any results, the penalty should be recommended for assessment. Only then should consideration be given for proposing revocation of the organization's exemption.

The key to revocation is determining that the organization's continued entitlement to exempt status is substantially in doubt. Based upon the facts and circumstances in each case the key district must make this determination. The basis for any revocation in such cases is that the organization has failed to provide information considered by the IRS to be material to a determination of continued recognition of its present status. Any proposed revocation must indicate the specific line items or information not provided, describe its relevance to status, and provide clear support for the conclusion that failure to provide the information logically or rationally leads to a pertinent question as to whether or not the organization is entitled to the exempt status currently recognized.

(3) Procedures for Examining Incomplete Returns

Since our new program is effective for 1983 calendar year returns filed in 1984, the KDOs should not assert the penalties on prior returns. For those years, every effort should be made to secure the years, needed information, educate the

organization in the filing of a complete return in the future, and where appropriate issue an advisory letter.

The primary aim of the agent upon discovering that a return being examined is incomplete is to secure the missing information and/or reasonable cause as to why it cannot be provided and advise and educate the taxpayer on how to properly file a complete and accurate return in the future. The missing information that is obtained should be associated with the return and would become a matter of public inspection. The organization should be advised of this and the appropriate advisory letter issued.

The penalty under IRC 6652(d) should only be recommended if the missing information is determined to be "material", the organization does not provide acceptable reasonable cause, and the organization does not provide the information. Any item omitted from the return which is required by IRC 6033 and applicable regulations would qualify as "material information." The list of officers, directors, and trustees and the list of the five highest paid employees are examples of items included in that category. However, the placement of figures on a wrong line and certain listings or schedules which are not totally or properly completed are simply errors for which application of the penalty would be inappropriate. Acceptance of the organization's return by the Service Center will not preclude assertion of the penalty. It is clear that the IRC 6652(d) penalty was enacted to ensure the filing of both a complete and timely return. As the penalty is imposed for failure to file "on time and in the manner prescribed" the penalty may be imposed from the due date of the return. While the failure to contact the organization in order to secure the missing information when the return is first filed, does not preclude assertion of the penalty from the due date of the return, we recommend that the full sanction be used sparingly and only in cases involving the most egregious facts and circumstances.

(e) Publicity

Since this will be the first time we have proceeded with the possible assertion of the \$10 per day penalty or possible revocation action for the filing of an incomplete return, it could generate some adverse comments from the public. Accordingly, prior to implementation of our program we did issue News Release IR-83-134 on October 24, 1983 to inform the public we intend to assess the penalty for failure to timely file a complete return as required. Similar language will be included on the cover of the Form 990 and 990-PF return packages. Early issuance of the News Release was planned to provide time for the various professional and

trade organizations to digest the information and disseminate it to others through their publications prior to the 1983 filing season.

5. Conclusion

The matter of incomplete returns is a topic you will be hearing about for some time to come. Even now Congress is drafting legislation requiring the Service to enforce all existing laws to secure the filing of complete returns. We believe our proposed program is a big step in the right direction and will substantially lower our rate of correspondence with filers, result in more reliable and accurate information being input into our system, reduce the number of complaints received from Congress and the public, and provide more complete information to those states that are accepting our Form 990 for their reporting requirements.

[EXHIBIT A not shown here]